[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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Over-Extension Precedes Correction

Recently, the direction of new inflows has been relatively consistent, with cyclical industries performing well and leading companies continuously hitting new highs. When their fundamentals have flaws or dividend yields are no longer attractive, "safe haven" assets may become a new source of risk, and over-extension will precede correction. On the other side, some industries' sub-sectors have already had large corrections, with improving fundamentals, they may become the new "scarce assets." It is now time for bottom-up value investors to think about positioning.

The performance of the Hong Kong stock market this year has been relatively good, not only because Hong Kong stocks have lower valuations and higher dividend yields, but also because the funds flowing into the Hong Kong market are more diverse and healthier. Both internal and external factors indicate that leading manufacturing companies need to go global, gradually achieving localization in terms of capacity, employment, supply chain, benefits, etc. (being near the shore is not as good as being on the shore), truly becoming global enterprises. Establishing overseas capacity is not an easy task and requires comprehensive consideration of factors such as supply chain system, production costs, talent reserves, and profit distribution. The leadership and resilience of these industry-leading companies are crucial. With different backgrounds of the times, the difficulty of growth will vary. In some times, having certainty is more attractive than having potential. The resilience and adaptability of these companies are crucial. Looking ahead, Rosefinch will cherish companies with strong fundamentals or positive expectations, reasonable valuation, and leading positions in the industry. We will actively cover outstanding healthy companies with both fundamentals and asset prices rising from the bottom. We'll track closely changes in fundamentals, their impacts on the market expectations, and position carefully for our investors.

Thinking about the new "scarce assets"

After the market adjustment in February, the third "National Nine Articles" following 2004 and 2014 has been launched, focusing on promoting the high-quality development of the capital market, aiming to enhance shareholder returns, strengthen regulatory risk prevention, crack down on fraud and manipulation, etc.

Low-risk assets are facing an "asset shortage", with the 10-year national bond yield fluctuating in the short term between 2.2-2.4%, the 30-year national bond yield falling below 2.5%, and the CSI REITs Index rising by 8.65% this year. Incremental funds are relatively consistent, with typical cyclical industries such as coal, oil, hydropower, and banks performing well, with leaders continuously hitting new highs. When their fundamentals are flawed or dividend yields are no longer attractive, "safe-haven" assets may become a new source of risk. What is the way out?

In the first half of the year, equity and equity-oriented mixed funds raised a total of 110.3 billion yuan, accounting for 15% of the total raised by public funds, with only 3 equity products having an issuance size of more than 1 billion yuan. The Hong Kong stock market has performed relatively well this year, not only because Hong Kong stocks have lower valuations and higher dividend yields, but also because the incremental funds flowing into the Hong Kong market are more diverse and healthier.

The economic data for the first half of the year shows that China's export growth has rebounded significantly from -8% in the first half of last year to a positive 10%. However, the overall economic growth rate has slowed by 0.4 percentage points compared to the first half of last year, and the total domestic demand has slowed significantly from the first half of last year, especially with consumer demand growth dropping to a rare 2%; the strong performance of exports also implies a long-term imbalance between domestic and overseas markets, which may further intensify external frictions.

With the gradual recovery of liquidity at home and abroad, the supply-demand relationship in the current stock market is likely to be favorable: on one hand, after three years of market adjustments, the supply side of the stock market (including various leverages and foreign funds) has been cleared, and the ratio of M2 to the total market value of A-shares (circulating market value) has reached a historically high level; on the other hand, the new "Nine Regulations" in the capital market have brought about institutional reforms, further improving the supply-demand balance in the stock market. Against this backdrop, certain sub-industries that are the first to adjust and clear out may show marginal improvement in fundamentals, potentially becoming new "scarce assets," and now is the time to consider layout from the bottom up.

Rosefinch patiently persists, focuses on building capabilities for the long term, cherishes leading companies with improving fundamental prospects or upward expectations and reasonable undervaluation, and strategically allocates resources; actively focuses on excellent healthy companies whose fundamentals and asset prices are at the bottom range, observes changes in fundamentals and market reflections, and attempts a contrarian layout while adhering to the interests of investors. It's okay to live in boring times, because only then can you have the opportunity to see high-quality assets priced below their true values. Asset managers must prove their research capabilities and investment decision-making in these difficult times.

Technological Innovation drives “industrial revolution”

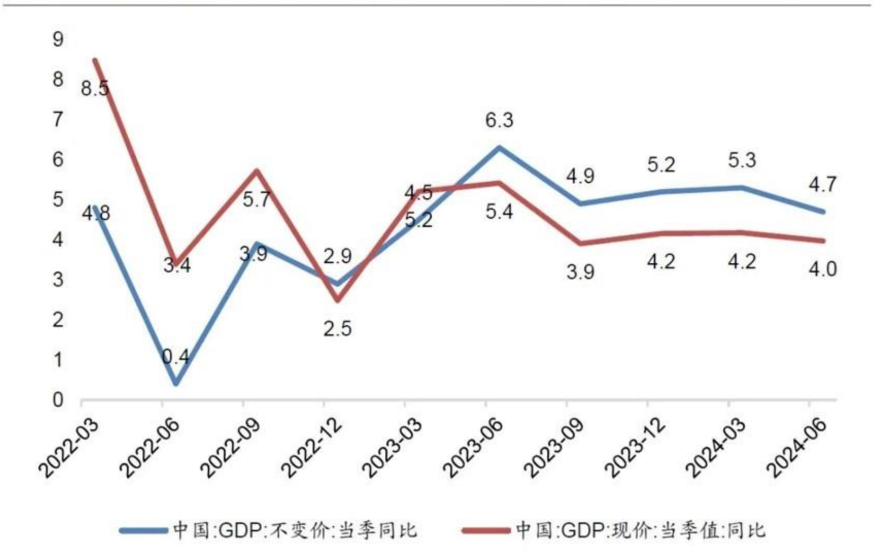
The strength of the United States also lies in its provision of a free and open platform, encompassing an open education and talent system, an open enterprise system, and an open financial system. The most developed regions in the U.S. include the Boston Bay Area, the New York Bay Area, and the San Francisco Bay Area, where immigrants and foreigners constitute 40% of the population. The so-called "Industrial Revolution" has invariably been driven by waves of technology: the First Industrial Revolution was propelled by steam power technology, with the U.S. being a "catch-up nation"; the Second Industrial Revolution was steered by electricity and internal combustion engine technologies, with the U.S. as a "concurrent nation"; the Third Industrial Revolution was driven by information technologies such as chips and software, with the U.S. as a "leading nation." OpenAI has now ushered humanity into the Fourth Industrial Revolution.

China holds a cost advantage in the field of new energy, while the United States boasts an innovation advantage in the realm of artificial intelligence. The economies of China and the U.S. should ideally be complementary. However, not every advancement in science and technology brings about political progress for humanity. Professor Yan Xuetong points out that from the technological advancements of 1900 to the present day, we have experienced World War I, World War II, the Cold War, and today's de-globalization. Technological progress is linear, but international politics advances and retreats intermittently.

From Globalization to Internationalization

In the second quarter of 2024, the actual GDP grew by 4.7% year-on-year, while the nominal GDP increased by 4.0%, which is lower than the 4.2% growth in the first quarter. The central nominal growth rate still awaits enhancement. Fixed asset investment from January to June rose by 3.9% year-on-year, and the total retail sales of consumer goods increased by 2% year-on-year. The national urban surveyed unemployment rate stood at 5%. In 2023, the year-on-year nominal GDP growth rates for the four quarters were 5.2%, 5.4%, 3.9%, and 4.2%, respectively.

图1：名义GDP当季同比（%）与实际GDP当季同比（%）



数据来源：Wind，广发证券发展研究中心

According to relevant statistics, when compared internationally, the proportion of disposable wealth to GDP for Chinese residents is approximately 43%, which is about 20 percentage points lower than that of developed countries and around 10 percentage points lower than countries with similar levels of development.

In 2022, the wage income of Chinese residents accounted for only 24.2% of GDP, whereas it reached 56.9% in the United States, around 48% in the European Union, and approximately 40% in Chile and

Mexico. According to OECD measurement standards, China's social welfare and security expenditure as a percentage of GDP was about 10.1% in 2022, while the average for OECD countries was 21.1%. Effectively stimulating demand in the second half of the year is a significant macroeconomic issue. The 20th Central Committee's Third Plenary Session proposed that "ensuring and improving people's livelihood in the course of development is a major task of Chinese modernization." It emphasized "addressing the most immediate and practical interests of the people, continuously meeting their aspirations for a better life, improving the income distribution system, prioritizing employment policies, enhancing the social security system, deepening healthcare reform, and establishing a comprehensive support and service system for population development."

The underlying conflict and tension between China and the West stem from changes in economic structures. Since 2009, China has been the leading country in terms of trade surplus, followed by Germany. From 2009 to 2019, China's annual trade surplus was roughly between $250 billion and $300 billion, while Germany's was between $200 billion and $250 billion, with China slightly ahead. However, by 2021, China's surplus surged to over $400 billion, while Germany's remained relatively unchanged. In 2022, China's surplus soared to $876 billion, significantly impacted by energy prices, with China's trade surplus accounting for nearly 80% of the global total. Currently, the United States holds the largest trade deficit globally, while China maintains the largest surplus.

The robust export performance also signifies long-term imbalances both domestically and internationally, potentially leading to external friction. Besides the EU's anti-subsidy investigation into Chinese electric vehicle imports, it has reportedly identified four risk points for Chinese enterprises: traditional chips, wind turbines, digital 5G networks, and clean energy biodiesel. The U.S. policy is even more explicit, with the term "globalization" being replaced by "internationalization" in government documents, reflecting a shift in focus from global cooperation to international cooperation involving fewer countries.

Tesla's Shanghai factory has recently announced that due to the light asset nature of the electronic and electrical supply chain, it is considering relocating this supply chain overseas, potentially extending to other products in the future. The "Trump Reciprocal Trade Act" aims to prioritize the United States, reduce trade deficits, and achieve comprehensive trade tariffs, with a clear goal of reshoring American manufacturing and supply chains, including the localization of chip production.

Friedman once wrote that while cheap imported goods might make a country wealthier overall, they can also harm a significant number of workers. The proportion of consumer spending in national income is very low, and with the declining working-age population and slowing technological progress leading to diminishing returns, the high levels of investment spending that previously drove economic growth have become unsustainable. The obvious solution is to transfer more income to households, thereby boosting consumer demand.

On the other hand, expanding overseas is an increasingly important trend. However, establishing overseas production capacity is no easy task, requiring comprehensive consideration of supply chain systems, production costs, talent reserves, and profit distribution. The trial and leadership of leading enterprises are crucial.

Amidst escalating global trade barriers and domestic overcapacity, China's photovoltaic industry seeks development in adversity. Benefiting from government subsidies and political correctness, the market value of the U.S. photovoltaic leader First Solar (FSLR) once exceeded $30 billion, making it one of the highest-valued photovoltaic companies globally. Chinese photovoltaic companies are accelerating their "going global" efforts. Two leading module companies have collaborated with local customers to establish and commence production in the United States. Several other companies are actively expanding in countries such as those in the Middle East, partnering with the world's fifth-largest sovereign wealth fund, PIF, which is a major investor in Saudi Arabia's "Vision 2030" and several large photovoltaic power plants. The leading power battery company has abandoned plans to build a factory in the U.S., opting instead for technology licensing services and announcing plans to establish factories in Germany and Hungary to meet European market demands.

Looking ahead

Investors are the cornerstone of the market. In recent years, the rising "pessimism" towards the financial industry has sparked market concerns. The Politburo meeting last July explicitly called for "activating the capital market and boosting investor confidence." Recently, the introduction of the new "Nine National Policies" and the "1+N" series of policy documents for the capital market have underscored the themes of stringent regulation, risk prevention, and the promotion of high-quality development in the capital market.

Serving the real economy is the fundamental purpose and foundation of the financial industry. The capital market must establish and perfect a market system and institutional mechanisms that align with the primary task of high-quality economic development to achieve its own high-quality growth. Developing new productive forces is an intrinsic requirement and a crucial focus for driving high-quality development. Supporting the development and innovation of new productive forces is both the responsibility of the capital market and a rare opportunity. It can be argued that the era of unrestrained capital growth has likely ended. Asset management institutions built on professional capabilities, dedicated to long-term service and sharing in the development of the real economy, and creating value for investors, remain essential and scarce, with vast potential.

Sequoia Capital's founder, Don Valentine, once summarized that throughout his decades-long investment career, he never strayed from the major track of semiconductors and computing technology, from chips to computers and peripherals, extending to software, communications, and eventually the internet. With different historical contexts, the difficulty of growth varies, and certainty can be more attractive than growth narratives.

In the era when small trees grow into large ones, Rosefinch has grown alongside the industry's development and expansion. Currently, with stringent regulations at the forefront, the Politburo meeting pointed out the lack of effective demand and geopolitical concerns. In a complex and increasingly uncertain world, higher standards are required for investment management capabilities and portfolio standards. The resilience and adaptability of industry companies are crucial, encompassing continuous innovation to maintain high profit margins, resource advantages, and strong balance sheets. Disciplined governance and outstanding entrepreneurial spirit are fundamental to meeting the challenges of transitional periods. From an investment return perspective, there is a greater expectation for returns to come from the asset manager investing in portfolio companies that create benefits and generate value for investors.

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