Thoughts on investing from the managers of

## Guinness Asian Equity Income Fund

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| **Objective** | Aiming for income and capital growth, the Fund invests in high quality dividend-paying companies in the Asia Pacific region |
| **Discipline** | Buys companies with persistently high return on capital over the last eight years |
| **Conviction** | Concentrated, equally-weighted portfolio of 36 stocks |


**Edmund Harriss**
(manager)


**Mark Hammonds**
(analyst)

## Asia versus Emerging Markets

# How Asia avoided a commodity crisis

**Asia's development as a manufacturing hub and mobilisation of its workforce has enabled it to avoid the worst of the commodity price slump that has hit other Emerging Markets hard. Its industry and services-led growth and its consumer markets stand it in good stead for the future.**

The BRIC economies have been a popular investment concept, but the economies of Brazil and Russia have proved too dependent on commodities. This was to their advantage as prices rose, especially during the China investment boom, but as this slowed, falling commodity prices left their economies cruelly exposed. Both notably failed to broaden their industrial bases in the good times. Their currencies have now weakened and both are struggling with recession and inflation.

The contrast with Asia is significant.

There are countries in Asia that are significant commodity producers (of oil, gas, iron ore, metals, rubber and palm oil). However, rather than relying on revenues from commodities (whose prices they cannot control), Asia's key strength is its development as a global integrated manufacturing hub.

The success of this process is visible in the resilience of the region to the global financial crisis.  More recently, benefits of falling commodity prices have greatly outweighed the negatives. Fuel costs have fallen to the benefit of end consumers and the governments that subsidised them; corporate margins have risen; and inflation pressures dampened.  The diversity and complexity of Asian manufacturing is the region's growth driver, and the associated wealth creation underpins the rise of Asia's consumers.

China's manufacturing industry epitomises "knitting" for the West.  China has developed at an extraordinary pace over decades, initially driven by basic labour-intensive manufacturing as the country cashed its 'demographic dividend'.  Textiles have long been its speciality, but as the abundance of cheap labour diminished, wages began to rise.  This increased disposable incomes, but it also created a challenge for textile companies, whose costs rose. The response has been emblematic for China Inc. Lower-end companies relocated to Bangladesh, Cambodia, Laos and Vietnam.  Those that stayed moved into more sophisticated textile products and invested in automation and efficiency.

Pacific Textiles and Shenzhou International both manufacture sophisticated mixed fabrics plus dyeing, printing and finishing.  These are used in a wide range of garments, including sportswear, swimwear and underwear for Uniqlo, Nike, GAP, M&S and Victoria's Secret.  The ability to produce quality materials efficiently in volume for demanding clients has enabled both companies to maintain margins well above sector averages, providing sufficient cash flows to sustain investment and dividend growth.

Growth in manufacturing means that consumption – considered a more stable source of growth – now constitutes a greater share of Asia's economies. China's recent economic policy has focused on managing the transition from investment-led to consumption-led growth. We hold a high portfolio weight in consumer sectors: 60% versus 38% for other sectors.

China Lilang is exposed to increasing demand in China for consumer fashion. Lilang is a designer and retailer of men's clothing, sold from over 3,000 outlets across China. It designs its own clothes and has a mixture of Chinese and European design teams. Its formula has been very popular, and it has maintained high returns on investment since 2006, while also expanding. Shareholders have benefited – it's paid out over 65% of earnings as dividends.

Taiwan, too, has built its economy on production, with particular expertise in electronics – both components and finished goods. While the technology industry is susceptible to rapid change and short product life-cycles, some companies have achieved impressive track records. We are seeing attractive investment opportunities, so Taiwan has a relatively high portfolio weight at 16%.

Catcher Technology manufactures high-quality metal casing used on the iPhone 6. These cases are produced to exacting specifications using CNC (Computer Numerical Control) machines. Not only must producers be able to meet the high standards of clients like Apple, they must also maintain standards while producing in high volumes.

Taiwanese technology manufacturer Asustek Computer has developed from pure manufacturer to a consumer brand (ASUS) in its own right. It started in 1989 as a component manufacturer specialising in motherboards noted for their stability and reliability. Asustek has gone on to become the world's number five maker of notebook PCs, and it also manufactures tablets and PC components under the ASUS brand. Asustek produces attractive products that compete with Western manufacturers; ASUS is becoming widely recognised as a consumer brand outside Asia, a trend we see across the region.

Asia has matured substantially over the past twenty years. Economic growth has slowed from the breakneck pace of the 1990s, and companies have learned to be more discerning in their investment decisions. More disciplined capital allocation and management have resulted in improved returns on investment and cash flows. A dividend-paying culture has spread, although it's yet to be embraced in Japan and South Korea.

Asia is now a global manufacturing hub with a rapidly expanding consumer sector. The diversification that these industries provide sets Asia apart from other emerging markets that are dependent on commodities. Many Asian companies are not yet household names, but this does not preclude them from achieving persistently high returns on capital that rival their western counterparts. Investors' lack of familiarity – plus fears about emerging markets in general – can create the attractive opportunities the region offers.

**Edmund Harriss**
**Guinness Asian Equity Income Fund**

**June 2015**

# Guinness Asian Equity Income Fund

The Fund is designed to provide investors with exposure to high quality dividend-paying companies in the Asia Pacific region. The Fund is managed for income and capital growth and invests in:

- **profitable companies...**
- **that have generated persistently high return on capital over the last eight years...**
- **and that are well placed to pay a sustainable dividend into the future.**

**Portfolio**

- Concentrated equally-weighted portfolio of 36 stocks, which reduces stock-specific risk and instils a strong sell discipline
- Low turnover
- Minimum $500m market cap
- No benchmark-led limits on sector & regional weightings

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| **Benchmark** | MSCI AC Pacific ex Japan Index |
| **Asset class** | Equity (long-only) |
| **Geographic focus** | Asia Pacific ex Japan |
| **IA sector** | Asia Pacific ex Japan |
| **Fund launch date** | 19.12.2013 |
| **Dividend payments** | Half yearly: July (interim) & January (final) |
| **Managers** | Edmund Harriss<br>Mark Hammonds (analyst) |
| **GBP share classes** | |
| ▸ **Bookbuild (first £30m)** | **0.25% AMC (0.74% OCF)** |
| ▸ Platform (no rebate) | 0.75% AMC (1.24% OCF) |
| ▸ Rebate | 1.50% AMC (1.99% OCF) |
| Accumulating and distributing classes and share classes in other currencies are available. | |

The Guinness Asian Equity Income Fund is an equity fund. Investors should be willing and able to assume the risks of equity investing. The Fund invests only in stocks of companies that are traded on Asian exchanges or that do at least half of their business in Asia; it is therefore susceptible to the performance of that region, and can be volatile. Details on the risk factors are included in the Fund's documentation, available on our website. Shareholders should note that all or part of the fees and expenses will be charged to the capital of the Fund. This will have the effect of lowering the capital value of your investment.

## Fund managers

**Edmund Harriss** has managed Asian Funds since 1994 both from London and Hong Kong. He worked for ten years from 1993 for Guinness Flight, which merged with Investec in 1998. He joined the Far East Investment Desk in 1994 as part of the team managing the China & Hong Kong Fund (now the Guinness Atkinson China & Hong Kong Fund, for US investors). In 1998 he moved to Hong Kong and became the Fund's lead manager. Edmund now manages Asia funds and China & Hong Kong funds in a Dublin OEIC for Guinness Asset Management and SEC-registered funds (for US investors) for Guinness Atkinson Asset Management. Edmund graduated from Christ Church, Oxford, with a Master's degree in Management Studies and has a Bachelor's degree in History from the University of York. He is an Associate of the Society of Investment Professionals.

**Mark Hammonds** joined Guinness Asset Management as an investment analyst in September 2012. Previously he qualified as a Chartered Accountant at Ernst & Young. Mark graduated from Corpus Christi College, Cambridge, in 2007 with a First Class degree in Management Studies.

## Guinness Asset Management

Guinness Asset Management provides a range of long-only actively managed funds to individual and institutional investors. Founded in 2003, Guinness is independent and is wholly owned by its employees.

We believe in in-house research, intelligent screening for prioritisation of research and well-designed investment processes. We manage concentrated, high conviction portfolios, with low turnover and no benchmark constraints. At heart Guinness is a value investor.

Since our establishment we have developed a variety of specialisms in global growth and dividend funds, global sector funds and Asian regional and country funds.

The Guinness funds sit within an Irish-listed OEIC. They are managed alongside a range of mirror SEC-registered funds offered to US investors by our US sister company, Guinness Atkinson Asset Management Inc.

We also offer Enterprise Investment Schemes investing in UK renewable energy projects and AIM-listed companies.