Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – August 2015

Launch date	**19.12.13**
Team	**Edmund Harriss** (manager) **Mark Hammonds** (analyst)

Aim

The Guinness Asian Equity Income Fund is designed to provide investors with exposure to high quality dividend-paying companies in the Asia Pacific region. The Fund aims to provide long-term capital appreciation and a source of income that has the potential to grow over time.

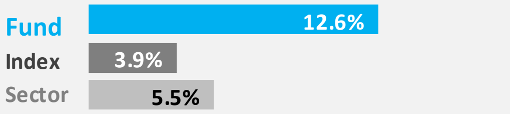
Performance (in GBP) 31/07/2015

Fund	Guinness Asian Equity Income (X)
Index	MSCI AC Pacific ex Japan Index
Sector	IA Asia Pacific ex Japan

	2012	2013	2014
Fund	-	-	17.6
Index	16.7	2.0	7.8
Sector	15.9	1.9	9.5

	1 year	2 years	3 years
Fund	10.8	-	-
Index	-2.5	3.7	15.5
Sector	0.4	5.7	19.3

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0	1.1	7.2
Beta	1	0.9	0.8
Info ratio	0	0	0.9
Max drwdn	-11.9	-10.8	-13.0
Tracking err	0	2.7	6.7
Volatility	11.6	10.9	11.5
Sharpe ratio	0.3	0.3	0.8

Past performance should not be taken as an indicator of future performance. The value of this investment and any income arising from it can fall as well as rise as a result of market and currency fluctuations.

Source: Financial Express, bid to bid, total return in GBP.

Questions from the road

We have begun to promote the Fund more widely in the past month and it has been well received – many have commented that its unique process among Asian funds is a big attraction – and we have started to see larger inflows. Since the end of June, assets under management for the fund have risen from $2.4m to just under $16m.

We believe there is a lot of benefit to be gained by meeting our clients, and the discussions that we have with them are often highly thought-provoking. In this month's brief, we answer questions on two subjects that crop up regularly: China and interest rates.

China

How has the fund fared with the recent volatility in Chinese stocks?

Investors in domestic Chinese stocks have had a wild ride over the past couple of months, and the recent fall of more than 30% in the Shanghai Composite Index has brought the market to the attention of all of those who invest in Asia. The large fall was preceded by an even larger run up over the past twelve months, as prices of domestic 'A' shares were bid up strongly, causing the index to more than double in value. Much of the bull market euphoria had been caused by retail investors (unlike western markets, the market is 80% dominated by retail investors, 20% by institutions) who saw the stock market as an opportunity to gamble. This tendency was exacerbated by the ready availability of leverage to retail investors – margin trading poured fuel on an already well-lit fire.

Tel: +44 (0) 20 7222 5703
Email: info@guinnessfunds.com
Web: guinnessfunds.com

GUINNESS ASSET MANAGEMENT LTD

Since the peak in June, the authorities have been fire-fighting in an effort to stem the falls that followed. The PBoC announced a cut in interest rates, and further cuts in the required reserve ratio to provide liquidity to the market. Further measures such as restricting short-selling, suspending IPOs and preventing company insiders from selling their shares were also introduced. So far these measures have had mixed success. The market has bounced a little from the lows reached in July, but it remains volatile.

The effect of these movements on the fund has been felt, but not directly. We do not invest in the A-shares that have been the subject of this volatility; we invest in Hong Kong listed Chinese companies (H-shares and Red Chips). These shares have at times come under selling pressure – during the period when there was a large number of A-share suspensions, many domestic Chinese investors sold H-shares instead in order to hedge their positions. However, the falls in share prices should be seen in the context of the significant outperformance they enjoyed in April.

Why does the fund have a large weighting to China? What is our long term view on the country?

We do not make top-down allocations within the fund. Our approach is bottom-up, and stocks are selected on the basis of their underlying fundamentals. While we consider the macroeconomic environment, this work feeds into our analysis of individual companies, rather than determining our allocation to a country or particular sector.

Our large weighting to China is therefore a function of our investment process, rather than a part of it. When we launched the fund, we found that many of value opportunities within our universe of quality companies were in (Hong Kong-listed) Chinese companies. This pattern was not unexpected, as China had been relatively unpopular for quite some time. The State Owned Enterprises (SOEs) and very heavy industrial companies that represent a large proportion of the market, have been very out of favour, as concern about slowing investment growth has severely dampened sentiment. However, we look at a different part of the market. Our focus is on quality companies that have generated persistently-high returns on invested capital that aren't highly geared, and many of the Chinese companies in our universe had been tarred with the same brush applied to the less attractive SOEs. Thus we were able to pick up many of the quality companies at pretty cheap valuations. While many have been strong performers for the fund since launch, we still find that the Chinese companies offer good value, and our portfolio, which has had very low stock turnover, continues to have a large weighting to China.

Our outlook for China for the next couple of years is generally favourable. While there are many challenges facing the authorities, including dealing with substantial amounts of debt incurred from investment and infrastructure spending, the ongoing liberalisation of financial markets, and the transition in the economy from investment and towards consumption, the Chinese have consistently demonstrated their willingness and ability to make significant structural changes in such a way that economic growth is not damaged. We expect growth to slow – it is a mathematical impossibility for the country to continue to grow at a high rate forever – but we expect the transition to be gradual.

Interest rates

How do we expect the fund will react to the prospect of rising interest rates?

One concern expressed by investors generally is whether there is still value in dividend paying stocks. As interest rates have remained at historic lows, held down by quantitative easing, the price of income generating investments has been bid up. Bonds trade at historically high prices, and bond-like assets have been similarly bid up. This effect is particularly prevalent for asset classes linked to stable sources of income generation, such as infrastructure. So are dividend paying stocks subject to the same pressure?

Our short answer is no, or at least, not in the areas in which we are investing. We still see Asia as being one of the areas around the world where there are good opportunities to find value. Dividend yields, an indication of value, are more attractive than Western markets, and on a P/E basis, the region trades at a significant discount to both US and world equities. As asset prices around the developed world have benefitted directly from quantitative easing-related buying, Asia has lagged the broad market, creating the opportunity we see today.

More fundamentally, the kind of companies we invest in are among those best placed to weather higher rates. Our focus on high return on capital companies means that they earn a positive spread of returns over the discount rate. This spread is important as it ensures that growth achieved by the company is accretive for shareholder value – it increases the company's intrinsic value. When interest rates increase, the discount rate at which a company's returns are discounted will increase, reducing the value of those returns. However, high return on capital companies will still earn well in excess of the discount rate – the large spread they enjoy acts as a cushion. Compare this with a company returning at the cost of capital. There is no room for the discount rate to increase before the company begins to earn a negative spread, meaning any growth achieved by the company is negative for shareholder value.

Since discount rates are notoriously difficult to estimate, we believe it is better to be approximately right, and to make an allowance for inaccuracy. By investing in companies with returns that significantly exceed the discount rate, the need for precision when estimating the discount rate is reduced. Even so, we still model the impact of changes in the discount rate – we can 'shock' the intrinsic value of the companies in our universe to see which are most sensitive to, say, a 1% increase in rates.

The other important part of our investment process is eliminating companies that are highly geared from our universe. This criteria has two main advantages. First, a company that has only modest levels of gearing is likely to be better able to service the interest payments on its debt. Second the valuation of its equity is less sensitive to changes in the value of its assets. Equity in highly geared companies – particularly those that are in distress situations – can be especially volatile, so we avoid this area of the market.

Overall, it is this combination of high return and low gearing that means our portfolio should be well positioned for increasing rates. Indeed for some of the companies in our portfolio, a rise in interest rates could even be beneficial. Aflac, a company introduced into the portfolio this month (see below), has found that the volumes of life insurance business that it is able to write profitably have been suppressed because the bonds it uses to invest insurance premiums have not been available at sufficiently high yields. As yields pick up, we expect the company to increase the volumes it can write, while maintaining profitability.

Edmund Harriss
Mark Hammonds

August 2015

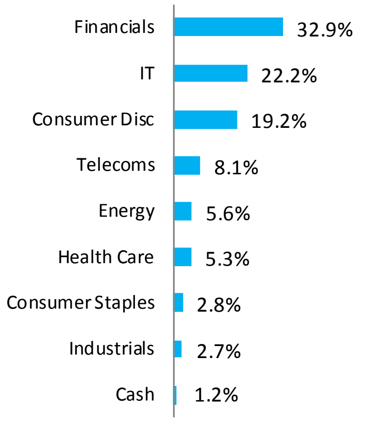
PORTFOLIO (30/06/15)

Fund top 10 holdings

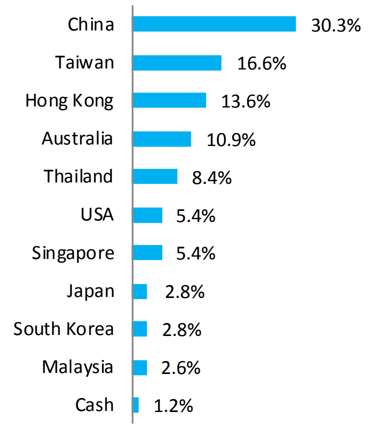
Henderson Group	2.9%
AAC Technologies	2.9%
Catcher Technology	2.9%
Asustek Computer	2.8%
PTT Public Company	2.8%
Luk Fook Holdings	2.8%
Relo Holdings	2.8%
Taiwan Semiconductor	2.8%
Shenzhou International	2.8%
China Mobile	2.8%

% of Fund in top 10	28.4%
Total number of stocks in Fund	36

Sector analysis



Geographic allocation



PERFORMANCE

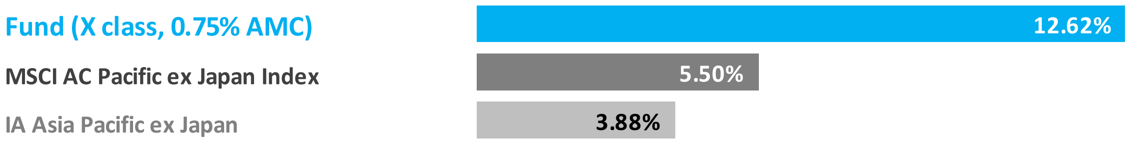
Discrete years % total return (GBP)

12 months to month end:	Jul '11	Jul '12	Jul '13	Jul '14	Jul '15
Fund (X class, 0.75% AMC)	-	-	-	-	10.8
MSCI AC Pacific ex Japan Index	16.8	-4.2	11.4	6.3	-2.5
IA Asia Pacific ex Japan	16.5	-8.8	12.8	5.3	0.4

Cumulative % total return (GBP)

31/07/2015	1 month	Year-to-date	1 year	3 years	From launch
Fund (X class, 0.75% AMC)	-5.2	2.6	10.8	-	21.1
MSCI AC Pacific ex Japan Index	-4.8	-2.3	-2.5	15.5	6.3
IA Asia Pacific ex Japan	-3.9	-1.5	0.4	19.3	9.0

Annualised % total return from launch (GBP) 31/07/2015



Risk analysis - Annualised, weekly, from launch on 19.12.2013, in GBP

31/07/2015	Index	Sector	Fund
Alpha	0	1.80	9.84
Beta	1	0.85	0.85
Information ratio	0	0	1.67
Maximum drawdown	-16.29	-14.59	-12.16
R squared	1	0.94	0.79
Sharpe ratio	0	0.18	0.88
Tracking error	0	3.10	5.49
Volatility	12.00	11.09	11.40

Past performance should not be taken as an indicator of future performance. The value of this investment and any income arising from it can fall as well as rise as a result of market and currency fluctuations.

Source: Financial Express, bid to bid, total return. Fund launch date: 19.12.2013.

Important information

Issued by Guinness Asset Management Limited, authorised and regulated by the Financial Conduct Authority.

This report is primarily designed to inform you about equities and equity markets invested in by the Guinness Asian Equity Income Fund. It may provide information about the Fund's portfolio, including recent activity and performance. It contains facts relating to the equity markets and our own interpretation. Any investment decision should take account of the subjectivity of the comments contained in the report.

This document is provided for information only and all the information contained in it is believed to be reliable but may be inaccurate or incomplete; any opinions stated are honestly held at the time of writing, but are not guaranteed. The contents of the document should not therefore be relied upon. It should not be taken as a recommendation to make an investment in the Fund or to buy or sell individual securities, nor does it constitute an offer for sale.

Risk
The Guinness Asian Equity Income Fund is an equity fund. Investors should be willing and able to assume the risks of equity investing. The value of an investment and the income from it can fall as well as rise as a result of market and currency movement, and you may not get back the amount originally invested. The Fund invests only in stocks of companies that are traded on Asian stock 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.

Documentation
The documentation needed to make an investment, including the Prospectus, the Key Investor Information Document (KIID) and the Application Form, is available from the website www.guinnessfunds.com, or free of charge from:-

- the Manager: Capita Financial Managers (Ireland) Limited, 2 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland; or,
- the Promoter and Investment Manager: Guinness Asset Management Ltd, 14 Queen Anne's Gate, London SW1H 9AA.

Residency
In countries where the Fund is not registered for sale or in any other circumstances where its distribution is not authorised or is unlawful, the Fund should not be distributed to resident Retail Clients. **NOTE: THIS INVESTMENT IS NOT FOR SALE TO U.S. PERSONS.**

Structure & regulation
The Fund is a sub-fund of Guinness Asset Management Funds PLC (the "Company"), an open-ended umbrella-type investment company, incorporated in Ireland and authorised and supervised by the Central Bank of Ireland, which operates under EU legislation. The Fund has been approved by the Financial Conduct Authority for sale in the UK. If you are in any doubt about the suitability of investing in this Fund, please consult your investment or other professional adviser.

Switzerland
The prospectus and KIID for Switzerland, the articles of association, and the annual and semi-annual reports can be obtained free of charge from the representative in Switzerland, Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva, Switzerland, Tel. +41 22 705 11 77, www.carnegie-fund-services.ch. The paying agent is Banque Cantonale de Genève, 17 Quai de l'Ile, 1204 Geneva, Switzerland.

Telephone calls may be recorded and monitored.