Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – April 2016

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

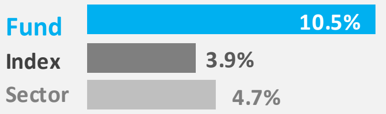
31/03/2016

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

	2013	2014	2015
Fund	-	17.6	1.2
Index	2.0	7.8	-4.4
Sector	1.9	9.5	-3.4

	YTD	1 year	From launch
Fund	5.0	-2.5	25.5
Index	4.9	-8.6	9.1
Sector	3.8	-8.1	11.0

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0	1.3	7.0
Beta	1	0.9	0.9
Info ratio	0	0.2	1.1
Max drwdn	-26.2	-24.5	-20.6
Tracking err	0	3.9	6.0
Volatility	15.7	13.8	14.3
Sharpe ratio	0.0	0.1	0.5

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.

Quarterly Review

In our monthly update in February, we described the behaviour of markets as puzzling. To put it in Benjamin Graham's terms it would appear that the first quarter was a period in which Mr Market let his fears run away with him. Those fears were of an economic crash in China, a collapse in global growth signalled by falling oil prices and a collapse in global liquidity or US recession triggered by rising US interest rates. By the end of March Chinese economic data point to stabilisation, the (Brent) oil price recovered from $26.39 per barrel in January to $38.72 and expectations of US interest rate rises have scaled back. Mr Market isn't afraid any more.

To continue in Graham's terminology, our approach is to buy 'sound stocks', in businesses that have generated real returns on investment on a cash flow basis that have been above the cost of capital and which we believe are likely to persist. We seek value by working out the difference between the return on investment profile of the business implied by the stock's current market price and the price we think it ought to be assuming the higher returns persist. Our portfolio consists of thirty-six such sound stocks that are equally weighted. We feel confident in following his advice:

"The investor with a portfolio of sound stocks should expect their prices to fluctuate and should neither be concerned by sizeable declines nor become excited by sizeable advances. He should always remember that market quotations are there for his convenience, either to be taken advantage of or to be ignored." Benjamin Graham, The intelligent Investor. 4th Ed.

During the quarter we changed no positions but rebalanced positions adding to those that had been hit hardest, taking away from those that had held up best. The fund ended the quarter 5.0% higher in GBP terms, ahead of the MSCI AC Pacific ex Japan Index, which rose 4.9%.

This all sounds very neat of course. If we look at the market as being a voting machine in the short term and a weighting machine over the long term it was apparent to us at the time that at the start of the year the market was simply voting. However, there is still much to weigh. While the intensity of the market response was overdone there are still very legitimate concerns and in our opinion these centre on debt and most especially on the possibility of a liquidity crunch exacerbated by that debt. For example, a stronger dollar puts pressure on emerging markets' currencies and liquidity. Slower economic growth and capital outflows from China hurts domestic Chinese liquidity that could then spill over. Lower oil prices put pressure on the economies of the commodity producers; ongoing demand weakness in Europe puts pressure on the Eurozone periphery and the European banking system…the list of matters to weigh goes on.

We cannot hope, and will not try, to resolve all these in this update but we there are reasons to expect more benign market conditions for the next few months. Policy decisions in China certainly seem to have taken on a more market friendly tone. Fiscal policy has been particularly supportive, and domestic growth appears to be gaining momentum. Fixed Asset Investment growth has picked up again and infrastructure projects have improved some of the economic measures typically associated with China's 'old economy'. The property market is buoyant with sales rising, inventory levels coming down and new starts up 41% year-on-year in February. We have also seen a 40% rebound in the price of steel in China making steel mills profitable once again. Domestic confidence in China has clearly improved: capital outflows have reduced significantly, foreign reserves increased in March for the first time since October and the Manufacturers' Purchasing Managers Index rose above 50 (meaning expansion) for the first time since July last year.

Concerns about China are longer term in nature. Market confidence in Chinese policymakers is now much lower than it was and is fuelled by policy contradictions. The policies we see now that are favourable to growth in the short term (infrastructure spending, monetary easing) are welcomed by stock markets and by also by Chinese consumers but they do not address, and may in fact make worse, the level of corporate indebtedness which is already high. The strength in the real estate market due to policy easing (on taxes, down-payments and mortgage rates) is undeniably beneficial to developers who can turn unsold units into cash; this reduces some of the financial risks associated with this sector but it does nothing to address affordability issues which keep the majority off the property ladder. Economic restructuring and transformation on the one hand and maintenance of stability on the other will continue to be a source of tension. Our view is that China risks should be viewed as playing out over time in the form of deleveraging and more sluggish growth rather than an imminent "Minsky moment" liquidity crunch. The basis of this opinion is that domestic confidence in China is maintained – and that is what is uppermost in the minds of policymakers today.

For Asia, and emerging markets more broadly, the weaker dollar has comes as a relief. The strength that had built up in 2015, began to reverse in 2016, with the Japanese Yen and the Euro appreciating notably. Following the market rout in January, and the consequential dovish signals sent by the Fed, expectations of further interest rate rises have moderated. The Renminbi has stabilised against the dollar, partly due to deferred US interest rate hikes, but also as further Chinese rate cuts have become less likely. Excluding Japan and China, Asian currencies have strengthened 4% this year on a weighted average basis.

There are signs that the dollar rally may have already reached a peak. Net long US dollar positions have been pared back to their lowest in two years according to Bloomberg and currency options are signalling a similar story. The divergence of interest rates between the US and the rest of the world has probably been priced in; we see that US core inflation has picked up quite smartly in recent months to 1.7% and we know the Federal Reserve is targeting 2% but unless there is a rapid reacceleration in the US tightening cycle or another market upheaval, we think dollar pressures on Asia should remain lower. This will be supportive in Asia by taking downward pressure off the Renminbi and would also help enable monetary easing in south-east Asia.

Emerging markets have seen revisions to profit forecasts begin to pick up but it is still early days. The rise so far is likely linked to currency effects (i.e. earnings have been revised up in dollar terms) but economic growth expectations have also increased recently as government spending effects feed through. The positive here is that government support has shifted from the provision of subsidies to outright spending. Thailand is a market where this has been more evident. The test in coming months will come when we see whether or not consumers pick up from where governments have left off.

An improving operating environment can also be seen in Producer Price Inflation numbers. Across the region companies have seen the prices of finished goods falling (in China for four years) and while it is mostly still negative there has been a marked improvement: in Thailand producer price inflation has moved from -5% to -2.4%, in Taiwan from -9.1% to -4.9%, in Malaysia from -6% to -1.6% and in China the steady deceleration down to -5.9% in December 2015 has improved to -4.3%. There are signs here that relentless downward pressure on wholesale prices is easing and, assuming manufacturing costs can be kept under control, we can expect to see support for margins. In other words, perhaps current earnings forecasts are too pessimistic and could rise further.

While markets are more sanguine than they were at the start of the year there is still, as we said earlier, much to weigh. The IMF continues to warn about the risks to global growth and the vulnerability to high debt especially when we look at bond yields at or near record lows. Our view is that rather than buy the market we want to buy into businesses whose management, financial structures and product offerings are such that they can continue to generate strong cash flows through the cycle. We have set a threshold for level and persistence of return on investment that only around 1,500 listed companies in the world have achieved and we select from a group of companies that operate in one the world's higher growth regions supported by a large population and rising consumer wealth. Sound stocks: good businesses at attractive valuations remains our focus.

Performance drivers

The focus of the fund is on companies that have demonstrated competitive advantages by generating a return on invested capital above the cost of capital over time. We invest in companies that we believe can sustain these returns, but are being valued by the market as though they won't.

This approach continued to work for the fund, which kept pace with the rising market to outperform over the quarter. The top performing stock, JB Hi-Fi, rose 34% in sterling terms during the quarter after reporting a good results for 2015 and strong trading at the beginning of 2016 (we wrote about the company in our brief last month). Two of our holdings in Thailand (a country where we hold an overweight position relative to the benchmark) also performed well: Delta Electronics Thailand rose 25%, and one of our energy holdings, PTT, rose 23% as oil prices recovered. AAC Technologies also made good gains (up 20%), regaining ground lost in December last year.

Economic conditions in Thailand have been relatively stable recently, buoyed by revenues from tourism. Foreign tourists increased by 16% in February from the previous year, with a greater number of Chinese visitors. Tax breaks introduced by the government to boost tourist spending have been extended until the end of the year. The Bank of Thailand's Monetary Policy Committee is currently forecasting GDP growth of 3.1% this year.

Poorer performing stocks included Belle International (down 21%), which warned on profits following continued declines in its footwear sales. Henderson was also weak, down 17%, as weak markets weighed on the asset management sector. China Lilang fell 15%, despite relatively good operating performance (see comments in our February brief).

On a sector basis, materials, energy and utilities were the strongest, with financials, industrials and healthcare the weakest. Our exposure to Chinese banks negatively affected performance in January, and despite their subsequent recovery, they were among the weaker performing stocks for the quarter.

We do not make allocations in the fund relative to the benchmark (indeed, we do not make top-down allocations), but we do monitor our exposure relative to the benchmark. Our largest overweight is in consumer discretionary, and we also have overweight positions in information technology, healthcare and energy. The fund is underweight materials, industrials, utilities, financials and consumer staples. Looking at our exposure to the largest five countries in the benchmark, we have overweight positions in China and Hong Kong, and Taiwan, and underweight positions in Australia and Korea.

Portfolio

Though we made no stock changes in the quarter, the volatility in the market provided opportunities to rebalancing the portfolio.

Following many companies reporting annual results in the quarter, we look again at the forecast dividend yield and growth rates on offer in the portfolio. At time of writing, the 2016 gross yield for the portfolio (using holdings at the end of the quarter) is forecast at 4.7%. Our bias towards income in the portfolio is clear, with the benchmark index yielding 3.6% (still a respectable figure relative to elsewhere in the world). Among the higher yielding stocks are our Chinese retail and discretionary companies and also Chinese banks. The lowest yielding stock in the portfolio, and the only stock to yield less than 2% is Relo Holdings, our Japanese position that yields 1.0%. Accompanying this lower yield, however, are higher expectations of dividend growth, with the 2018 yield forecast to reach 1.4%. For the portfolio as a whole, the yield is expected to grow to 4.9% and 5.2% for 2017 and 2018 respectively, equating to growth rates of 4.1% and 6.0%. Actual levels of dividends received will be reduced due to withholding tax and may vary due to any stock switches that are made. Of course the outturn may also differ from the current forecasts.

Outlook

We maintain our focus on companies whose prospects, we believe, are undervalued by the market. The combination of attractive cash-based returns on investment and growing dividend streams off the back of good returns is an attractive one, we believe. While recent economic data from China have been relatively robust, figures from Korea indicate the global trade continues to be weak (Korea is a bellwether of global trade because of the broad range of goods it exports - machinery, heavy equipment, cars, electronics, consumer goods etc.).

The problem of weak trade, however, is not specific to Asia, and we believe the low valuation the region trades on takes this into account. The MSCI AC Pacific ex. Japan index at quarter end traded at around 1.39x price to book and around 6.6x price to trailing cash flow – discounts of 21% and 33% respectively to average, and both at levels previously seen at times of crisis. By investing in companies that have achieved sustained profitability over time, we hope that our portfolio will be able to weather such lacklustre short term economic conditions.

China Breakfast

To discuss some of the issues above facing China, and the challenges facing the economy, we are hosting a breakfast on 28th April. Edmund Harriss will discuss the following subjects:

- China's GDP growth rate – what is it and can we believe it
- How the economic model is changing – who wins and who loses
- The condition of China's banks and the financial system
- The Chinese consumer and the risks posed by property market
- Where value can be found China & Asia

Please contact your sales representative if you would like to come. We hope to see many of you there!

Edmund Harriss (portfolio manager)
Mark Hammonds & **Sharukh Malik** (analysts)

April 2016

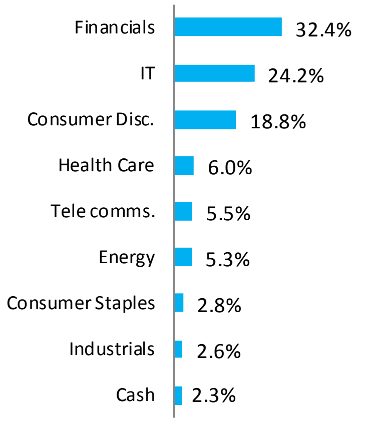
PORTFOLIO

31/03/2016

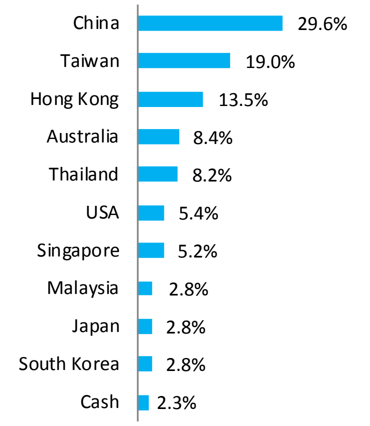
Fund top 10 holdings

St. Shine Optical Co	3.2%
AAC Technologies	3.0%
LPN Development	2.9%
China Merchants Bank	2.9%
Sonic Healthcare	2.8%
BOC Hong Kong	2.8%
DiGi.COM	2.8%
Relo Holdings	2.8%
Nagacorp	2.8%
JB Hi-fi	2.8%
% of Fund in top 10	28.9%
Total number of stocks in Fund	36

Sector analysis



Geographic allocation



PERFORMANCE

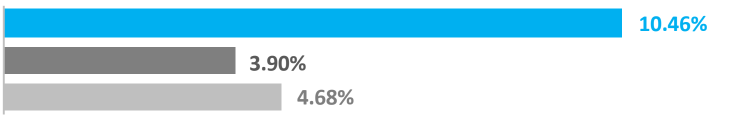
31/03/2016

Discrete years % total return (GBP)	Mar '12	Mar '13	Mar '14	Mar '15	Mar '16
Fund (X class, 0.75% AMC)	-	-	-	28.6	-2.5
MSCI AC Pacific ex Japan Index	-5.5	17.3	-7.0	18.4	-8.6
IA Asia Pacific ex Japan	-6.0	16.0	-6.9	19.4	-8.1

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	From launch
Fund (X class, 0.75% AMC)	5.1	5.0	-2.5	-	25.5
MSCI AC Pacific ex Japan Index	8.1	4.9	-8.6	0.7	9.1
IA Asia Pacific ex Japan	6.2	3.8	-8.1	2.2	11.0

Annualised % total return from launch (GBP)

Fund (X class, 0.75% AMC)
MSCI AC Pacific ex Japan Index
IA Asia Pacific ex Japan



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

31/03/2016	Index	Sector	Fund
Alpha	0	1.26	7.04
Beta	1	0.85	0.85
Information ratio	0	0.22	1.07
Maximum drawdown	-26.15	-24.54	-20.58
R squared	1	0.95	0.85
Sharpe ratio	0.01	0.08	0.48
Tracking error	0	3.85	6.00
Volatility	15.66	13.76	14.34

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. 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.