Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – May 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.

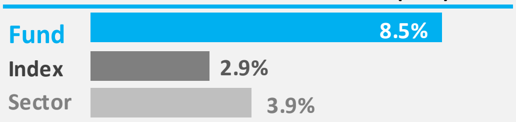
Performance (in GBP) 30/04/2016

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	1.6	-10.3	21.4
Index	2.8	-13.1	7.0
Sector	2.4	-10.5	9.4

Annualised % total return from launch (GBP)



Risk analysis (annualised, weekly, from launch)

	Index	Sector	Fund
Alpha	0	1.1	6.0
Beta	1	0.9	0.8
Info ratio	0	0.2	0.9
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	0.0	0.4

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.

Markets

China continues to dominate the Asian region and its monthly economic data releases hold considerable sway over regional and global markets. The beginning of the year was characterised by acute China fears which have subsided in recent months as macro data showed signs of renewed momentum. This momentum is however temporary and the data will almost come in below expectations in coming months. Investors should be not be surprised by this and importantly need to understand why this is so.

Chinese economic policy is not confusing and nor is it contradictory. The old model of investment-led growth passed its "Sell by" date in 2010 and has left a legacy of debt and excess capacity which policymakers are now trying to resolve. The effect of reducing industrial capacity and unwinding debt is to drag down economic growth and because this investment-led sector is so large the challenge is to achieve this without destabilising the whole economy.

This means that the implementation of this policy has to be punctuated by periods of policy support before progress on the larger project can be resumed. This is what we have seen over the last 9 months or so: weaker data leading to policy support resulting in economic stabilisation. And this policy support is now being scaled back. China is not falling back into its old ways or 'reaching for the bottle' as some have it. China is addressing the practical social economic and political problem of reducing the role of heavy industry and construction in economic growth which employs over 100 million people and redirecting resources and people to more productive areas.

In a recent article in the People's Daily, a government mouthpiece, presented a formal view

in a question and answer format. The bare bones are this:
The inherent problems of the economy persist in spite of recent stabilisation and policy focus will shift back from demand side stabilisation to supply side reform. The economic trend will remain L-shaped for a period of time, not just 1-2 years. The focus must be on supply side reform but demand side stimulus helps create the environment to solve the supply side problem; excessive stimulus however, risks excessive credit growth that would threaten the financial system. At the same time employee settlement is of the utmost importance in the process of excess capacity reduction.

Investors seem uncertain about how to read the information they are given. Some things are more visible and easier to measure than others but that does mean they are informative. There is little to be gleaned from Chinese domestic stock market moves and currency moves are little better. The identification of economic stress day-to-day is best sought in Chinese money market rates such as the 7-day repo rate and Shanghai Interbank rate. These both remained absolutely stable before and after the market upheavals back in January.

We are fed continually a diet of worrying news on China debt levels presented in the form of a Debt to GDP ratio of 280%. However, when we consider the ratio for the US is 334%, the UK 296%, Brazil 133% and Argentina 63% (a similar level to that prior to its default in 2001) the ratio begins to look a lot less useful. When looking at the history of debt crises the debt to GDP ratios just prior are all over the map which means: they are not very helpful. So what should we look at?

In each case the important considerations are whether the debt problems are sovereign or private, whether they are bank, corporate or household debts, whether the funding sources are external or domestic. Each have their own characteristics and manifest differently. In China's case, the borrowers are largely corporate, banks are on the hook for it and the sources of funding are primarily domestic. Sovereign debt levels in China are low and given a significant proportion of local government borrowing (which took the form of corporate debt rather than municipal debt which was not available) was triggered by central government policy requirements there is scope for government debt levels to increase. This is similar to the role taken by governments in central banks in developed markets, with the difference that China's government borrowing starts at a much lower level.

If China does have a problem their debt crisis will be a domestic one triggered by internal factors. One area that is perceived to be a key risk is residential real estate. China is clearly overbuilt with an overhang of unsold inventory which magazines like to highlight in the form of 'ghost cities' of vacant developments. These do exist but for investors to form a view of just how risky the sector is we should consider the following. In 2015 Chinese property sales were strong: 1.124 billion square metres were sold raising RMB 7.275 trillion. In more usable format: 12-15 million apartments were sold raising US$ 1.12 trillion dollars at a price of $92.50 per square foot. This puts the average cost of an apartment at $75,000. There are 450 million square meters of unsold inventory and that equates to 5-7 million apartments with a value at current prices of $448 billion.

There are a number of points that flow from this. We focus on central Beijing and Shanghai property prices that run at $1,200 per square foot (London is $2,500 and New York is $1,600) but this is not representative of the bulk of China. The average price in 2015 was $92.50. The second point is that developers were able to convert property into cash and as long as there are cash flows then the system still functions. Unsold inventory of $448 billion is a lot but it equates to total bank lending in January and February this year; it equates to 4% of GDP.

We do not seek to underplay the scale of the challenges facing China and our analysis of the property market can and does go much further. We simply make the point that China challenges are not well understood and presented in a fashion that often leads to poor decision making. Over the next few months we will produce a series of research papers designed to help cut these problems down to size and help our investors decide whether markets have got it right or whether, as in January, they bear a closer resemblance to Keystone Cops.

The most immediate takeaway is the importance in the first instance of buying into businesses that are well run, with good products and strong operating cash flows and which are not dependent upon policy support to help them. In the case of China there is a dynamic manufacturing, services and consumer-led segment and the legacy segment. Our job is to buy into those businesses feeding into the former and work out the degree to which the risks posed by the latter will affect companies' operations and valuations. It remains our view that the market's assessment of China risks is overdone and thus presents an opportunity to buy into good businesses as attractive valuations.

Performance drivers

The focus of the fund is 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.

There were two main trends that affected performance in April: one positively and one negatively. The positive trend was the continued recovery in the oil price, which benefitted our energy holdings PTT and CNOOC. We took the opportunity to sell CNOOC into this strength (see section below). Our other good performers for the month came from a variety of sectors. KT&G, our Korean tobacco holding, released better than expected first quarter results. The company has been dealing with the effects of a hike in domestic tobacco tax in the first quarter of 2015, but saw impressive year-on-year volume increases for first three months of 2016, partly benefiting from market share gains. The company also had good results in its overseas tobacco division, which exports to the Middle East, China and Southeast Asia and Russia.

Two of our Chinese retailing stocks China Lilang (men's fashion) and Belle International (ladies' shoes and sports trainers) also made good gains during the month, recovering some of the ground lost in the first quarter. Retail in China, as elsewhere, is a competitive business, and operators must retain careful control over their costs and working capital. Both companies have demonstrated an excellent track record of returns on capital, which we think positions them well to cope with short term headwinds. Both are also set to benefit from rising consumer incomes in China as wages and disposable incomes increase. More recently, Belle's share price was buoyed by the news that Adidas's first quarter sales in China rose 30% – evidence that the consumption transformation is well under way.

The main negative trend to affect the portfolio was the underperformance of information technology companies, particularly those in the Apple supple chain. It was widely broadcast that Apple iPhone sales for the first quarter disappointed the market, and the uncertainty surrounding the growth outlook for the company has hit its share price. Correspondingly, many of the companies that supply parts for the iPhone – Catcher (metal casings), Largan (cameras) and AAC (speakers) – also suffered. The situation is not dissimilar to that at the end of December 2015, as the market became concerned that the immense global success of the iPhone wouldn't continue. In the short term, we are optimistic that the launch of the new iPhone (expected in the second half of the year) will boost demand once again. Many of these companies also have a range of customers other than Apple that contribute to their returns. As with the Chinese retailers, these companies have achieved an impressive track record of strong returns on investment, consistently over time.

Portfolio

During April, we made two changes to the portfolio. We sold our position in CNOOC following the recovery in the oil price. The company had fallen out of our universe as its CFROI fell below 8%, and returns were not forecast to recover imminently. We replaced the company with DBS Group, a Singapore-listed diversified bank with 280 branches across 17 markets. DBS has a market cap of $28bn and an historic yield of 4%.

The second change we made in the portfolio was to sell out of our position in NagaCorp (a casino operator in Cambodia). We had become increasingly concerned about the transformational expansion projects that the company was undertaking, in particular the effect that high capex would have on future free cash flow. The company put out a good operational update for the first quarter in April, and we took advantage of a spike in the stock price on elevated volume to exit our holding. We purchased Tisco Financial, a financial services company specialising in car hire purchasing loans in Thailand. Tisco has a captive market for loans for Ford and Mazda, and is likely to benefit from an improvement in underlying asset quality, resulting in reduced provisioning costs. We think that the valuation is undemanding, and the stock is supported by a strong dividend yield.

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. The effect of these portfolio changes has been to make us overweight in financials, and underweight in energy. Our largest overweight is in consumer discretionary, and we also have overweight positions in information technology, healthcare and financials. The fund is underweight materials, industrials, utilities, consumer staples, energy and telecommunications. 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.

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

May 2016

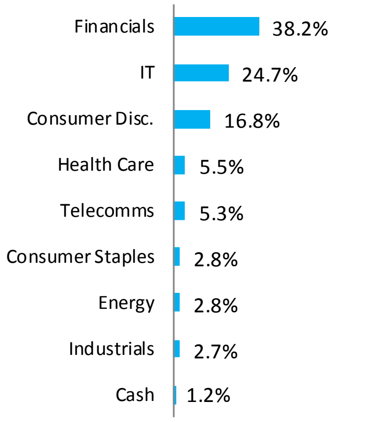
PORTFOLIO

30/04/2016

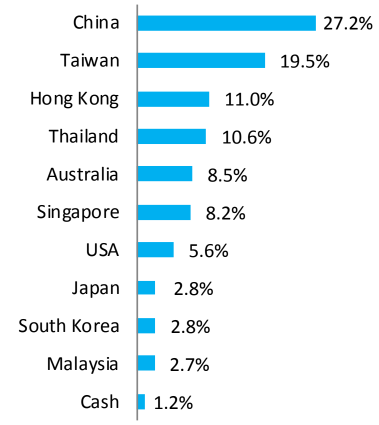
Fund top 10 holdings

Novatek Microelectronics	3.0%
Luk Fook Holdings	2.9%
LPN Development	2.9%
JB Hi-fi	2.9%
Relo Holdings	2.8%
Asustek Computer	2.8%
Henderson Group	2.8%
Qualcomm	2.8%
KT&G Corporation	2.8%
Pacific Textiles	2.8%
% of Fund in top 10	28.6%
Total number of stocks in Fund	37

Sector analysis



Geographic allocation



PERFORMANCE

30/04/2016

Discrete years % total return (GBP)	Apr '12	Apr '13	Apr '14	Apr '15	Apr '16
Fund (X class, 0.75% AMC)	-	-	-	35.2	-10.3
MSCI AC Pacific ex Japan Index	-6.8	18.1	-7.0	22.2	-13.1
IA Asia Pacific ex Japan	-8.0	16.9	-6.8	20.9	-10.5

Cumulative % total return (GBP)	1 month	Year-to-date	1 year	3 years	From launch
Fund (X class, 0.75% AMC)	-3.3	1.6	-10.3	-	21.4
MSCI AC Pacific ex Japan Index	-2.0	2.8	-13.1	-1.3	7.0
IA Asia Pacific ex Japan	-1.4	2.4	-10.5	0.8	9.4

Annualised % total return from launch (GBP)

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

30/04/2016	Index	Sector	Fund
Alpha	0	1.07	5.95
Beta	1	0.84	0.84
Information ratio	0		0.91
Maximum drawdown	-26.15	-24.54	-20.58
R squared	1	0.95	0.85
Sharpe ratio	0.00	0.02	0.36
Tracking error	0	3.86	6.01
Volatility	15.69	13.77	14.32

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.

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