# Guinness Asian Equity Income Fund

**INVESTMENT COMMENTARY – January 2017**

| | |
|---|---|
| **Launch date** | **19.12.13** |
| **Team** | **Edmund Harriss** (manager)<br>**Mark Hammonds** (analyst)<br>**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** 31/12/2016

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

| | 2014 | | 2015 | | 2016 | |
|---|---|---|---|---|---|---|
| | USD | GBP | USD | GBP | USD | GBP |
| **Fund** | 10.7 | 17.6 | -4.4 | 1.2 | 7.5 | 28.2 |
| **Index** | 1.8 | 8.1 | -9.4 | -4.1 | 7.8 | 28.6 |
| **Sector** | 3.1 | 9.5 | -8.6 | -3.4 | 5.3 | 25.7 |

| | YTD | | 1 year | | From launch | |
|---|---|---|---|---|---|---|
| | USD | GBP | USD | GBP | USD | GBP |
| **Fund** | 7.5 | 28.2 | 7.5 | 28.2 | 15.7 | 53.2 |
| **Index** | 7.8 | 28.6 | 7.8 | 28.6 | 1.6 | 34.6 |
| **Sector** | 5.3 | 25.7 | 5.3 | 25.7 | 1.5 | 34.4 |

**Annualised % total return from launch**

| | USD | GBP |
|---|---|---|
| **Fund** | 4.9% | 15.1% |
| Index | 0.5% | 10.3% |
| Sector | 0.5% | 10.2% |

**Risk analysis** (annualised, weekly, from launch)

| | Index | | Sector | | Fund | |
|---|---|---|---|---|---|---|
| | USD | GBP | USD | GBP | USD | GBP |
| **Alpha** | 0 | 0.0 | -0.1 | 1.2 | 4.6 | 6.1 |
| **Beta** | 1 | 1.0 | 0.9 | 0.9 | 0.8 | 0.9 |
| **Info ratio** | 0 | 0.0 | 0.0 | 0.0 | 0.8 | 0.8 |
| **Max drwdn** | -29.1 | -26.2 | -26.7 | -24.5 | -24.3 | -20.6 |
| **Tracking err** | 0 | 0.0 | 4.1 | 4.1 | 5.8 | 5.8 |
| **Volatility** | 15.4 | 16.2 | 13.8 | 14.4 | 13.0 | 14.7 |
| **Sharpe ratio** | 0.0 | 0.4 | 0.0 | 0.5 | 0.1 | 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, gross total return.

## Three-year anniversary

The fund passed a significant milestone in December and is now three years old. Since launch the fund the fund has returned 53.2% (in GBP, 15.7% in USD) versus 33.4% (1.7% in USD) for the MSCI AC Pacific ex Japan Index, and 34.4% (1.5% in USD) for the IA Asia Pacific ex Japan sector average. The fund is ranked sixth in the IA sector (out of 89 funds), and is first out of Asian equity income funds in the sector.

Over the course of 2016, we grew the fund from £14.2m at the beginning of the year to £29.7m.

Our forthcoming three-year review will take a detailed look at how our strategy has fared in each year since inception and how its results have been achieved.

## Markets and performance

This was a testing year for the fund which ended the year up 28.2% (7.5% in USD) versus the benchmark MSCI AC Pacific ex Japan Index which rose 28.6% (7.8% in USD), and one on which we can look back with some pride. The portfolio did underperform the market and that is not something to be pleased about. But the way we have gone about it, the types of business in which we invest and the valuation anomaly we look to capture has delivered 'good' returns based on businesses in which we have confidence.

The fund did well defensively in the weakness in the early part of 2016 and captured the rally in June. In the second half however, the fund had to contend with the strong recovery in energy and materials prices to which it has low exposure, a falling Korean Won amidst Korea's domestic troubles and with rising interest rate expectations that hurt the REIT positions in the last quarter. Nevertheless, having underperformed for five months in the second half, through what was by any stretch a difficult period, the fund outperformed in December in falling markets.

The Guinness Asian Equity Income Fund rose 0.5% in sterling terms (-0.6% in USD) in December versus a decline of 0.1% (-1.1% in USD) for the MSCI AC Pacific ex Japan index.

This period also included three significant macro events. First, at the end of September OPEC agreed an outline for cutting oil production, a reversal of its strategy begun in 2014. Second, the expected course of the US Presidential election was turned on its head with the election of Donald Trump accompanied by a substantial change in economic policy. Third, an issue in Korea surrounding allegations of influence peddling ballooned into a full blown political scandal that resulted in a vote to impeach the President.

December was a month of relative tranquillity for Asian markets. After the shock US election result in November, and the resulting fall-out on the region, this came as somewhat of a relief. While Asia fell towards the end of December, US and global equity markets continued their post-election rally.

US markets have been quick to discount a more expansionary policy by the incoming administration. With higher domestic growth expected as a result, US stock prices have risen. Since higher inflation is also expected, bond yields are up in anticipation of rising interest rates, which in turn has caused the dollar to strengthen against most currencies, Asian currencies included. Whether this rally in equity markets is capable of being sustained is questionable. We address the election result further in our Outlook section below.

Thai stocks continued their rally in December after bouncing back from the initial drop on the news of King Bhumibol Adulyadej's death in October. Fears of political instability in Thailand have subsided as it has become clear that the succession will take place without further disruption. Our four Thai stocks were the best performers in the portfolio in December.

In contrast with Thailand, the political scandal in Korea has unsettled financial markets. The ongoing saga of allegations of wrongdoing against President Park — which culminated in mass organised demonstrations and plummeting approval ratings — was brought to a head on 9 December, when the South Korean National Assembly voted to impeach Park, suspending her from office. One of our Korean holdings, KT&G, was among the portfolio's worst performing stocks in December, falling 3.8% in local currency terms, but 6.1% in US dollar terms (4.0% in sterling).

Commodity prices continued their strength at the end of the year, led by oil after the decision by OPEC on 30 November to cut production. In October and November energy, financials and materials were the best performing sectors where the portfolio is underweight. (Because the fund invests in companies that have achieved comparatively stable returns on capital over time, we tend to have relatively low exposure to energy and materials companies.) The fund underperformed in these two months even though overall market conditions were weak, conditions in which in more normal times we would expect to outperform. We were pleased to see this was short-lived, with market behaviour stabilising in December and the fund outperforming.

One of the key differentiators of the fund from its peers is that the selection and performance of the portfolio, while it will definitely be affected, is not dependent upon macro conditions. We do not seek to benefit from or defend against specific macro events but instead our focus is very much on individual quality stocks. Our assessment of the macroeconomic backdrop affects our evaluation of a stock's expected future returns, but it is the companies themselves that take centre stage.

# Portfolio

We made no changes to the portfolio in December.

# Outlook

We see three potential consequences for Asia of the US election result: changes in trade policies, its effect on the US domestic economy and interest rates, and the potential for changes in Asia-focussed diplomatic relations. (The last of these factors seems to have taken a back seat recently in comparison to current diplomatic relations between the US and Russia.)

The potential negative impact of more restrictive trade policies on Asia was the one of the main factors behind the sell-off in Asian equities, both preceding and immediately after the election. Our technology manufacturing stocks, including those in Taiwan, were among those that fell most heavily. Despite this period of weak performance, technology was one of the best performing sectors for 2016 as a whole. Yet again, this underlines the importance of selecting individual stocks for the long term over making short-term thematic bets.

We see it as unlikely that Trump will be able to impose tariffs on Asian countries to anything like the degree which he has suggested. Moreover, the appetite among US consumers to pay more for consumer electronics is simply not there. There is the potential for changes in tax treatment of overseas expenditure by US companies, but current policies appear to be at an early stage. Meanwhile the long-term shifts of globalisation (see below) march on.

The Trump administration's domestic policies are expected to be inflationary, which should secure or even accelerate interest rate rises by the US Federal Reserve. This is supposedly bad news for emerging markets including Asia, although as we wrote last month most countries in the Pacific region have little to fear from rate rises, having trade surpluses, low foreign debt exposure, well-capitalised banks and low inflation.

The manner in which many of the next administration's domestic policies have been proposed, although high-profile, makes it difficult to judge how far and how quickly they will be enacted. The tone of the next round of US earnings reports will be instructive of whether corporate management is looking ahead with confidence of higher government spending and deregulation or caution around a higher dollar, rising interest rates, and rising stakes in trade policy. Not all of these are bad from an Asian perspective; a stronger dollar, if a result of a stronger US economy, is a good thing; greater restrictions on trade quite the opposite. US markets appear to be enjoying the relative certainty now that the election itself is over, although what this says about the factors above is impossible to say.

The case for investing in Asia remains unchanged:

- A quarter of the world's quality companies are in Asia. Of the 1,900 companies globally that meet our criteria for quality, 500 of them are located in Asia.
- Valuations are attractive. Asian equities trade at a substantial discount to global equities. At the end of December, the MSCI AC Pacific ex Japan Index traded on a 14.1x p/e ratio, compared with the MSCI World Index on 18.1x. The fund trades at a further discount – at the end of the year the fund was on a p/e ratio of 11.4x.
- Asia provides a good source of diversified income. We target companies with moderate yields that are capable of growing their dividend over the long term. The trailing yield of the fund is 3.9%, and the companies in the portfolio have on average grown their dividends at 9.3% per annum over the past five years.
- Asia economies are generating robust, sustainable growth. While a demographic tailwind has played a part in the region's success, the development of a regional manufacturing hub has helped countries to move up the value-chain by producing increasingly sophisticated goods. We see this clearly in China, but elsewhere in Asia too – Thailand's exports are becoming an increasingly important part of the supply chain. The long-term trends of globalisation seem unlikely to be halted any time soon.

2017 will doubtless bring uncertainties and surprises, as every year does. This is why we build a portfolio of attractively valued companies that have demonstrated an ability to deliver high returns on capital for eight years in a row. We think this is the best thing to own at the start of a new one – and, indeed, at any time.

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

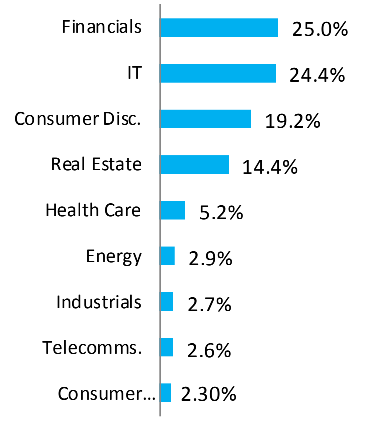
## PORTFOLIO

**31/12/2016**

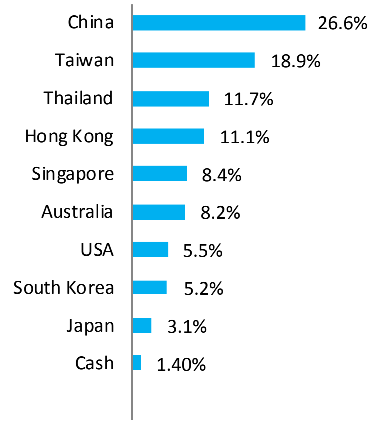
### Fund top 10 holdings

| | |
|---|---|
| LPN Development | 3.4% |
| Largan Precision | 3.2% |
| Relo Holdings | 3.1% |
| Luk Fook Holdings | 3.0% |
| DBS Group Holdings | 3.0% |
| PTT Public Company | 2.9% |
| Tisco Financial Foreign | 2.8% |
| BOC Hong Kong | 2.8% |
| Hanon Systems | 2.8% |
| JB Hi-fi | 2.8% |
| % of Fund in top 10 | 29.9% |
| Total number of stocks in Fund | 36 |

### Sector analysis




### Geographic allocation




## PERFORMANCE

**31/12/2016**

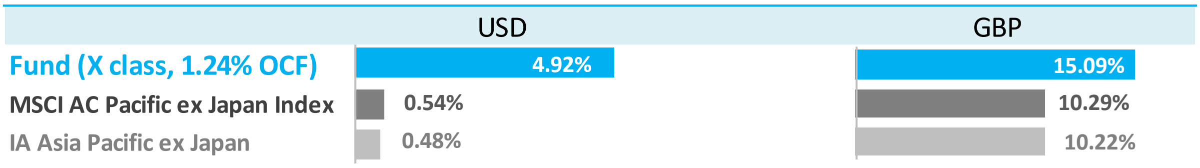
### Discrete years % total return

| | Dec '12 | | Dec '13 | | Dec '14 | | Dec '15 | | Dec '16 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | USD | GBP | USD | GBP | USD | GBP | USD | GBP | USD | GBP |
| Fund (X class, 1.24% OCF) | - | - | - | - | 10.7 | 17.6 | -4.4 | 1.2 | 7.5 | 28.2 |
| MSCI AC Pacific ex Japan Index | 22.3 | 17.0 | 4.2 | 2.3 | 1.8 | 8.1 | -9.4 | -4.1 | 7.8 | 28.6 |
| IA Asia Pacific ex Japan | 21.2 | 15.9 | 3.8 | 1.9 | 3.1 | 9.5 | -8.6 | -3.4 | 5.3 | 25.7 |

### Cumulative % total return

| | 1 month | | Year-to-date | | 1 year | | 3 years | | From launch | |
|---|---|---|---|---|---|---|---|---|---|---|
| | USD | GBP | USD | GBP | USD | GBP | USD | GBP | USD | GBP |
| Fund (X class, 1.24% OCF) | -0.6 | 0.5 | 7.5 | 28.2 | 7.5 | 28.2 | 13.8 | 52.5 | 15.7 | 53.2 |
| MSCI AC Pacific ex Japan Index | -1.1 | 0.0 | 7.8 | 28.6 | 7.8 | 28.6 | -0.6 | 33.3 | 1.6 | 34.6 |
| IA Asia Pacific ex Japan | -1.5 | -0.4 | 5.3 | 25.7 | 5.3 | 25.7 | -0.8 | 33.0 | 1.5 | 34.4 |

### Annualised % total return from launch




### Risk analysis - Annualised, weekly, from launch on 19.12.2013

| 31/12/2016 | Index | | Sector | | Fund | |
|---|---|---|---|---|---|---|
| | USD | GBP | USD | GBP | USD | GBP |
| Alpha | 0.0 | 0.0 | -0.1 | 1.2 | 4.6 | 6.1 |
| Beta | 1.0 | 1.0 | 0.9 | 0.9 | 0.8 | 0.9 |
| Information ratio | 0.0 | 0.0 | 0.0 | 0.0 | 0.8 | 0.8 |
| Maximum drawdown | -29.1 | -26.2 | -26.7 | -24.5 | -24.3 | -20.6 |
| R squared | 1.0 | 1.0 | 0.9 | 0.9 | 0.9 | 0.9 |
| Sharpe ratio | 0.0 | 0.4 | 0.0 | 0.5 | 0.1 | 0.8 |
| Tracking error | 0.0 | 0.0 | 4.1 | 4.1 | 5.8 | 5.8 |
| Volatility | 15.4 | 16.2 | 13.8 | 14.4 | 13.0 | 14.7 |

**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, gross 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.