Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – February 2017

Launch date	**19.12.13**
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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

31/01/2017

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

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

	YTD	**1 year**	**From launch**
Fund (USD)	4.7	19.8	21.1
Index (USD)	5.9	24.0	7.7
Sector (USD)	6.5	22.4	8.0
Fund (GBP)	2.8	35.1	57.5
Index (GBP)	4.0	39.8	40.0
Sector (GBP)	4.6	38.0	40.5

Annualised % total return from launch

	USD	GBP
Fund	6.3%	15.7%
Index	2.4%	11.4%
Sector	2.5%	11.5%

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.

Monthly update

- For the moment markets are looking toward domestic US policy enactments that are likely to generate growth.
- Life has clearly become more complicated outside the US as the President seeks to redefine the world via Twitter and is none too bothered about sugar-coating it. The speed of policy evolution and its delivery, rather than the manner of it, is the challenge.
- The best approach we can think of is to put money behind good quality businesses that have demonstrated their strength by generating a return on capital that has been higher than the cost of that capital for many years and therefore is likely, we believe, to continue.
- Asia trades at a 27% discount on a price/earnings ratio basis to developed markets and our portfolio trades at a 14% discount to Asia.
- Our two fundamental questions continue to guide us in our decision to invest in a company and at what price:
    - "Will the returns on investment of the past carry on into the future?" and
    - "What discount rate will we apply to value those returns?"

Markets and performance

The Fund rose 2.8% in GBP, 4.7% in USD, and 2.2% in EUR (X class, gross total return) in January compared to the benchmark which rose 4.0% in GBP, 5.9% in USD, and 3.4% in EUR (MSCI AC Pacific ex Japan Index, gross total return). This relative performance, with 80% upside capture for the Fund, is in line with what we expect in these stronger market conditions.

The performance of Asia and of emerging markets more broadly has been much stronger than developed markets this year, but they had been relatively weaker in December. Looking at the last two months together, developed and emerging markets have moved roughly in line (up between 4% and 5% in dollar terms). This performance suggests they are looking at a different set of issues from the news media. The story is all about President Trump and while the news media focuses on his enactment of US immigration policies and foreign relations, markets appear to be looking forward to the enactment of domestic economic policies designed to stimulate US growth.

There are two macro areas that will occupy markets this year and with which investors in Asia will also have to contend (in addition to the issues in China, North and South Korea, and Thailand which we have mentioned in previous updates):

1. US policy

We expect that US domestic needs will now be placed above foreign policy priorities, especially with respect to trade. President Trump has complained about 'unfair' trade practices relating to almost all trade agreements and individually against China, Japan and Germany, saying it's time to 'stop being taken advantage of'. In fact, the situation of which he complains is the result of a conscious fundamental policy decision. For forty years, since the Nixon era, trade has been a tool of US foreign policy: by opening its own markets to outsiders while accepting more restricted access for its own companies in return, the US has acquired greater geopolitical clout because foreign economies now benefit so greatly from that US market access. The cost has been born by American workers, although benefits have accrued to US consumers. Even twenty years ago workers and consumers could be considered one and the same, but since then they have splintered into those of the old industrial production sectors who have lost out and those of the New Economy who have gained. Whether this was a policy choice or basic unfairness, Trump is set on reversing the tide.

One immediate concern for Asia and anyone else exporting into the US is the possible implementation of a border adjustment tax. This would mean that only costs incurred in the US are deductible for the tax calculation on profit as opposed to the prior arrangement in which costs incurred overseas were also recognised. This will clearly hurt margins for US distributors and the burden will be shared with overseas suppliers. This is not a done deal and lobbying is underway but something along these lines looks likely. Such a move might be preferable to a selective imposition of tariffs. It would affect all countries' competitiveness versus the US but not against each other, putting the EU, China and the rest of Asia on an equal footing. A second issue is the Trump administration's attitude toward China. Peter Navarro, a professor of economics and public policy, has been appointed as the head of the President's new US Trade council. He has published a number of books including one titled *Death by China*, which gives some sense of his views. He also recently described the euro as 'an implicit deutschmark' suggesting Germany is behind its weakness to extract a trade advantage.

It seems clear that Trump is intent on changing the basis on which the US conducts its trade and is also driven by a need to increase tax revenues to fund tax breaks he wishes to introduce domestically to generate growth. However, it is also true that the global supply chain has developed rapidly and is based upon more than just low-cost labour. Technology, logistics, communications, know-how and capital have all combined in a highly competitive package. Trump wants to move quickly but he is not seeking to adapt to the new world but to turn back the clock to the 1950s and 1960s in terms of America's trade. We don't think it will work.

Our response therefore is to focus on companies whose production skills, product development, capital allocation and customer relations put them at the forefront of either the global supply chain or their domestic markets. Trade growth in any case has been slowing and the US market, though still important, is not the growth driver it once was. The wealth of the emerging world is increasing and new markets are opening up. From China's standpoint specifically, these trends could also serve to speed up their own economic transition to develop domestic consumption. We need to focus on the ability of our companies to continue to generate the cash flow based returns they achieved in the past and we also need to be conservative when applying a discount rate to value those returns.

2. Europe

Europe is under increasing political and financial strain, conditions that are not conducive to problem solving. The UK has voted to leave the European Union and although the UK government lost its case in the Supreme Court that requires the matter to be put to a vote in Parliament, it has just received an overwhelming parliamentary endorsement. Therefore the UK will move toward its exit. At the same time, elections in France, the Netherlands and Germany are coming up this year with similar issues that dominated the UK referendum and the US election holding sway.

Debt issues in the Eurozone have not received much attention lately. Italy narrowly averted a banking crisis over Christmas and the fundamental problems remain in the Italian banking system. Greece is also about to come back into focus with another debt payment coming due later this month. Greek bond yields have started to climb again, with the 10 year government bond yield at 7.36%, 1% higher than at the beginning of December 2016. To be sure, they are nowhere near the 30% level of March 2012 but it is a reminder that this is (another) problem deferred, not solved.

Our response, as before, is to focus on the companies in which we invest rather than try to make a macro-based decision. Our two fundamental questions, "Will the returns on investment of the past carry on into the future?" and "What discount rate should we apply to value those returns?", continue to guide us in our assessment of whether we want to invest in a company and how much we should we pay for its shares.

Company news

In keeping with our stock-specific approach, the best performing stocks over the past month have been technology companies Largan Precision and Catcher Technology from Taiwan; AAC Technologies from China; Hong Kong jewellery retailer Luk Fook; three banks in Hong Kong, Singapore and China; PTT, an energy company in Thailand; and Belle International, a Chinese footwear designer and retailer.

Underperforming positions included Hanon Systems (Korean auto-parts), Henderson Group (asset management), China Construction Bank, Li & Fung (a Hong Kong-based factory agent), and St Shine Optical (a Taiwanese maker of contact lenses). The outstanding laggard however was Qualcomm which fell 18% in the month and we topped up the position. This followed news of a lawsuit brought against it by Apple complaining about unreasonable business practices. Qualcomm's model is to levy a charge on any device that incorporates its technology, based on the overall price of the device. Apple's point is that its devices contain features unrelated to Qualcomm technology that allow it to charge a premium price which it must then share with Qualcomm. Lawsuits in this sector are frequent and the sums sought are generally substantial but we believe the share price drop was overdone.

Companies that reported this month include Ascendas REIT and CapitaMall Trust in Singapore, Largan Precision and TSMC in Taiwan, KT&G in Korea, Tisco in Thailand and Aflac in the US. Ascendas reported its third quarter results which were ahead of expectations while CapitaMall full year results were flat. Both are potentially vulnerable to higher US interest rates but they both offer the prospect of dividend growth and all their financing needs are covered. Largan's results were solid rather than spectacular but management's outlook points toward sustained earnings growth over the next two years thanks to new dual camera smartphones and the settlement of its own lawsuit (as we said, these are frequent in this sector) which should allow it to cut into the single lens compact camera module market (where car cameras are likely to follow smartphones as a big source of demand for Largan's products). Taiwan Semiconductor (TSMC) offered no surprises and was a market performer during the month.

KT&G posted strong results, as expected, but some analysts had hoped there would be a (positive) change to the dividend policy. As it was, the company kept to its long-term policy and stock has fallen back. We do not think sticking to the policy is a problem and therefore we remain buyers on the weakness. In Thailand, Tisco Financial reported results which although slightly below expectations for net profit were strong at the operating level. The bottom line was weaker was because it increased its provision coverage of non-performing loans. Building bad debt provisions when times are good is something we are very pleased to see in a company such as Tisco Financial. Thailand was the epicentre of the Asian financial crisis in 1998 and to see a Thai finance company (whose consumer lending is inherently riskier) exercising prudent provisioning policies through the cycle is what will

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support cash flow returns and dividends over time, in our view. Finally Aflac, which generates over 50% of its revenue from Japan, reported results that missed forecasts for the fourth quarter of 2016. The stock was a significant outperformer in 2016 but has experienced weak sales in the last two months. This is the product of higher staff turnover in the US business since Aflac linked compensation more closely to new sales. The company is optimistic for the coming year based on stabilisation in the US, but its operations in Japan are the main driver.

Outlook

The portfolio as it stands today is trading on a price/earnings valuation discount of 14% to Asia, which in its turn is at a 27% discount to developed markets. The portfolio's prospective yield is 59% better than the market's and represents a distribution of 55% of expected profits. All of these companies are high quality businesses as we define the term (with high and sustained return on invested capital), and we believe they are well positioned to cope with greater global uncertainty.

While it is reasonable to be concerned about the world at large we still believe it is more useful and worthwhile to worry about our companies. Can they continue to generate the superior returns on investment that they achieved in the past? How will policy changes and new international relationships impact upon that ability? How will we value the shares of these companies in the light of possible changes to interest rates, inflation expectations or tax? By thinking about our investments in this way we believe we can find good quality businesses at the right price. And we think that's what we have.

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

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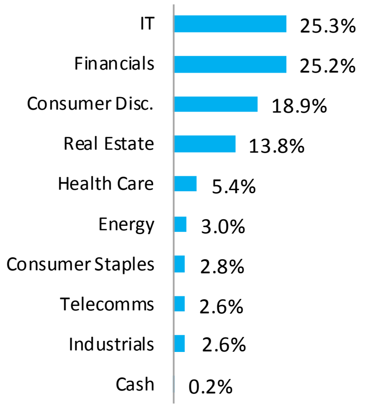
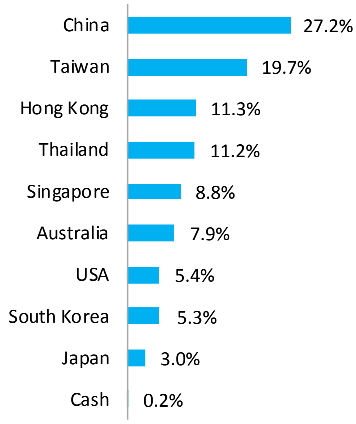
Fund top 10 holdings

Largan Precision	3.3%
DBS Group Holdings	3.2%
Luk Fook Holdings	3.1%
BOC Hong Kong	3.1%
Relo Holdings	3.0%
PTT Public Company	3.0%
Ascendas Real Estate Trust	2.9%
Catcher Technology	2.9%
AAC Technologies	2.9%
China Merchants Bank	2.9%
% of Fund in top 10	30.5%
Total number of stocks in Fund	36

Sector analysis



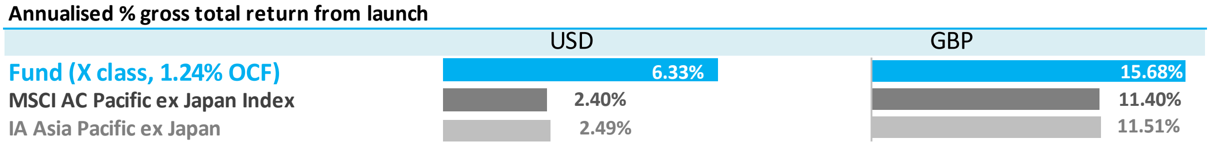
Geographic allocation



Discrete years % gross total return	**Jan '13**	**Jan '14**	**Jan '15**	**Jan '16**	**Jan '17**
Fund (USD)	-	-	17.7	-10.9	19.8
Index (USD)	14.5	-3.6	8.4	-17.4	24.0
Sector (USD)	14.4	-4.1	9.7	-17.3	22.4
Fund (GBP)	-	-	28.7	-5.7	35.1
Index (GBP)	14.0	-7.0	18.7	-12.5	39.8
Sector (GBP)	13.9	-7.5	20.1	-12.4	38.0

Cumulative % gross total return	**1 month**	**Year-to-date**	**1 year**	**3 years**	**From launch**
Fund (USD)	4.7	4.7	19.8	25.6	21.1
Index (USD)	5.9	5.9	24.0	11.1	7.7
Sector (USD)	6.5	6.5	22.4	11.1	8.0
Fund (GBP)	2.8	2.8	35.1	64.1	57.5
Index (GBP)	4.0	4.0	39.8	45.1	40.0
Sector (GBP)	4.6	4.6	38.0	45.1	40.5

Annualised % gross total return from launch



Risk analysis - Annualised, weekly, from launch on 19.12.2013

31/01/2014	**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

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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.

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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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