Guinness Asian Equity Income Fund

INVESTMENT COMMENTARY – April 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 31/03/2017

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	12.0	10.7	17.6	35.2	29.6	69.6
Index	12.5	11.2	18.5	36.2	14.3	49.6
Sector	12.9	11.6	17.5	35.1	14.6	49.9

Annualised % total return from launch

	USD	GBP
Fund	8.2%	17.5%
Index	4.2%	13.1%
Sector	4.2%	13.1%

Risk analysis (annualised, weekly, from launch)

	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0	0.0	0.6	1.7	4.9	6.0
Beta	1	1.0	0.9	0.9	0.8	0.9
Info ratio	0	0.0	0.0	0.0	0.7	0.7
Max drwdn	-29.1	-26.2	-26.7	-24.5	-24.3	-20.6
Tracking err	0	0.0	4.0	4.0	5.8	5.8
Volatility	15.2	15.9	13.6	14.1	12.8	14.4
Sharpe ratio	0.0	0.6	0.1	0.7	0.4	1.0

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.

Early investor share class to close May 2017

The Fund has continued to grow this year and we are happy to report it's currently over $40 million. A warm welcome to any new investors in the Fund. We'd like to announce that the early investor 'Z' share class (OCF 0.74%) will be closing to new investment (other than from registered charities) on 12th May 2017.

Quarter in Summary

The Fund rose more than we would normally expect in such strong markets, rising 10.7% in GBP, 12.0% in USD and 10.5% in EUR (X class, total return) compared to the MSCI AC Pacific ex Japan Index ('the Index') which rose 11.2% in GBP, 12.5% in USD and 10.9% in EUR. This represents over 95% upside capture, whereas in strong markets we would normally expect 75%-85% upside capture on average.

Closer analysis shows the greatest market strength was in January, when the Index rose 5.92% in USD terms and the Fund captured 75% of that rise, which is in line with our expectations. In February and March the Index rose less sharply (3.30% and 2.87%) and the Fund outperformed by 0.80%.

Leading stocks in January were technology names, Chinese retail and banks in China, Hong Kong, Singapore and Thailand. Later on, we saw stronger individual stock moves post-results which drove outperformance, notably from Yangzijiang Shipbuilding and Catcher Technology.

Overall, Asian markets outperformed developed markets as measured by MSCI World Index in each of the first three months of the year. This rally reversed much of the underperformance in Q4 2016 and over 6 months Asian and Developed markets have performed in line.

We believe the factors driving this recovery include:

- Improved profitability in Chinese heavy industry and the return of producer price inflation to positive territory after 4½ years
- a recovery in commodities prices
- improving asset quality in China's banking sector
- reduced political risk associated with future US policies on trade
- upward revisions to earnings estimates post-results.

Outlook for the region

Asian markets still look cheap after this rally and are trading at a 29% discount on a PE basis to the world.

US relations with China, surely the most important bilateral relationship in the world today, seem much more constructive than many feared.
We expect China's current economic strength and the recently improved profitability of its heavy industrial sector will allow China to intensify efforts to resolve its structural issues of debt and excess capacity. Therefore, we do not expect growth to accelerate further and in fact it may slow from here.

The recent results season has prompted analysts to upgrade profit forecasts more broadly across countries in Asia and across sectors. This could provide extra confidence to those looking to allocate more money into the region.

The latest news from the region focuses on North Korea. There are no ready answers but any solution must involve both the US and China working together. Beneath the public positions of these two, it appears that they are in fact working closely together following the timely Trump-Xi summit meeting in Florida.

Markets

While writers in publications such as the Wall Street Journal and Financial Times continue to focus on the challenges China faces to achieve economic reform, markets appear now to be focusing on more positive developments. In the 12 months to March 31, MSCI China has outperformed Asia Pacific, Emerging Markets and the S&P 500. Consensus profit estimates are forecasting earnings growth of more than 13% and a forward Price/Earnings (P/E) multiple of 11.1.

Improved profitability among China's heavy industrial companies, which began last year, is an important reason. A recovery in commodity prices combined with a revival of investment spending in China saw a jump in profits and cash flows. The benefits have spread into the banking sector, whose most indebted customers have now seen their debt servicing capacity improve. Consequently we have seen the banks report slower non-performing loan formation. Earlier estimates of hidden non-performing loans in the system have been scaled back. A recovery in the value of the renminbi this year (up 0.8% against the dollar) from its lows at the end of 2016 and a continued rally in prices of Chinese stocks traded in Hong Kong have added to the optimism.

At the same time, the central bank has been active in managing domestic liquidity through open market operations and has not been afraid to tighten in order to push forward its de-leveraging agenda. Interest rates in the interbank market have gone up twice this year and liquidity provision has been reduced in recent weeks, all designed to encourage greater prudence. The bank regulator has signalled its intent to tighten up its regular macro-prudential assessment of banks' capital adequacy by including new categories of credit including wealth management products. This will require banks to set aside more capital and thus should act as a restraint on shadow banking activity. Another focus is the housing market, where big price rises in the largest cities have caused concern.

Singapore and South Korea also outperformed during the quarter. In Singapore, strong economic growth driven by manufacturing was behind a strong rise in January which carried on into February, with upward revisions to Q4 2016 GDP growth providing extra impetus. In South Korea, the impeachment of President Park ended a political crisis that had engulfed the country. At the same time, a strong rebound in technology produced some of Asia's largest upgrades to profit forecasts, and stock prices followed. In both countries, stronger stock prices in local currency terms have been given a further lift by a stronger exchange rate against the dollar.

The leading sectors in the quarter were Technology, Health Care, Consumer Discretionary and Real Estate, followed by Financials. Technology has been the best performing sector this year across developed and emerging market regions with smartphones, memory chips and displays all doing well. Samsung Electronics is investing heavily in new memory chip production capacity and Toshiba is also receiving strong interest for its memory business.

Portfolio

Yangzijiang Shipbuilding rose 43% after a period of rather more moderate performance. Its results were better than the market had expected and so the deep discount on its share price narrowed. We hold this stock because it has achieved returns above the average cost of capital and this set of results sustains that level of return. We had been rebalancing into the stock during its prior weakness and have reaped the full benefit of this recovery, allowing us then to rebalance away following the rally. We are now at equal-weight.

Half of the top ten performers in the quarter were technology names. Catcher, AAC Technology and Largan Precision are associated with smartphones. Asustek is a PC/tablet producer and Novatek is a chip designer for high definition displays. However, the performance was not just the product of our technology stocks. In addition to Yangzijiang, we also have Tisco Financial (auto financing in Thailand) Luk Fook (China/HK jewellery retail), China Lilang (men's apparel) and Ascendas REIT (industrial property in Singapore) in the mix.

On the weak side, we have Qualcomm (-11%), which is presently facing legal issues both from the Federal Communications Commission (FCC) and from Apple against the perceived unfairness of its licensing model. Nevertheless, it is still a leading chip designer for smartphones and has agreements with all the major Chinese smartphone manufacturers. We have been adding to the position on weakness. JB Hi-Fi is an Australian discount retailer of electrical goods whose 12% underperformance during the quarter follows a 50% rise in 2016, well ahead of the 7.5% rise of broad market. Hanon Systems is a Korean company specialising in climate control systems for the auto sector, for both internal combustion engine and electric vehicles, where the temperature control is linked to greater fuel efficiency and battery life. The company is well managed, is diversifying its customer base and has moved to paying a quarterly dividend which itself is unusual for a Korean company. Li & Fung has disappointed for a while. The factory agency business operates with very fine margins and the volumes that Li & Fung needs to put through have remained elusive while global trade growth has been weak. The fifth weakest stock was China Minsheng Bank. It is the weakest of the banks we hold, with a greater reliance on wholesale funding, a greater exposure to small and medium-sized companies and more leverage than the group. This is one we are watching closely.

Fund Outlook

Even after this rally, Asian markets trade at a PE discount to the world of 29%. With the Fund trading at further 11% discount to that, we think there is real value to be had. The portfolio offers earnings growth of 6% this year and 8% next year, which is not in itself especially eye-catching, but we believe the opportunity comes in the higher predictability and stability of that earnings profile which we see as undervalued by the market. Higher earnings growth is available in basic materials and energy, which are recovering from lows on the back of a 'reflation trade' which itself is far from certain, in our view.

The arguments for Asia are in part external, in that the US looks expensive yet many have overweight exposure to it, and in part internal, since a cyclical recovery in China is now prompting a re-appraisal of the region. In this respect, a recovery in earnings revisions in Korea, China, Thailand and Indonesia as well as across Energy, Materials, Industrials, Consumer Discretionary and Technology all helps. The bulk of revisions is concentrated in Korea and China and in Energy and Materials. Revisions in the rest are more modest, but they are evident.

From our perspective, the reflation story in Asia is one we welcome because it is positive for sentiment and reduces risk premia, allowing for multiple expansion. However, it is not a story in which we would look to invest. Improved profitability, cash flows and asset quality in China will likely lead to an intensification of economic rebalancing efforts. Higher pre-provision operating profit for banks will result in more aggressive charge-offs of non-performing loans – good for the economy as a whole but not the fuel for a further rerating of bank shares, for example, which are already up over 40% from their lows. Reflation stories are not just confined to China; Malaysia, Taiwan and Thailand are all embarking on domestic spending programmes.

There are risks all around to this outlook: political risks, US valuation risk, interest rate risk, currency risks, European electoral risks – just about anything you can think of these days. However, some of these are subsiding. The recent Sino-US summit was far removed in tone from Trump's earlier rhetoric. Trade intervention, either in the form of border adjustment taxes or imposition of tariffs, now seems more remote (but has not gone away). Geert Wilders underwhelmed in the Dutch elections and Le Pen in France does not seem to be reaching out beyond her core supporter base.

Our focus however, remains on companies that have operated and flourished (in terms of returns on capital over time) in this higher-growth region – but are not dependent upon that growth.

Edmund Harriss & Mark Hammonds
(portfolio managers)
Sharukh Malik (analyst)

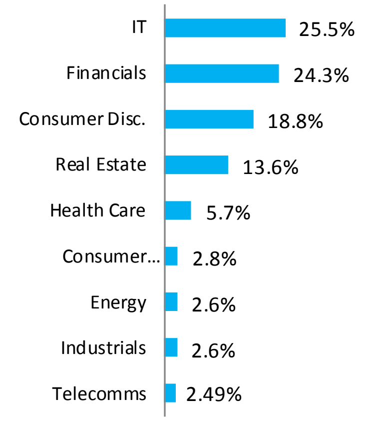
PORTFOLIO

31/03/2017

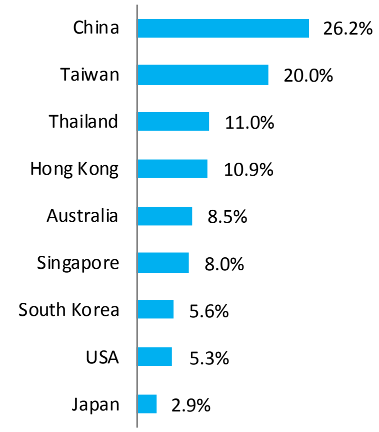
Fund top 10 holdings

Catcher Technology	3.2%
Tisco Financial Foreign	3.0%
Asustek Computer	3.0%
Largan Precision	2.9%
AAC Technologies	2.9%
Relo Holdings	2.9%
JB Hi-fi	2.9%
St. Shine Optical Co	2.9%
Sonic Healthcare	2.9%
Hanon Systems	2.9%
% of Fund in top 10	29.4%
Total number of stocks in Fund	36

Sector analysis



Geographic allocation



PERFORMANCE

31/03/2017

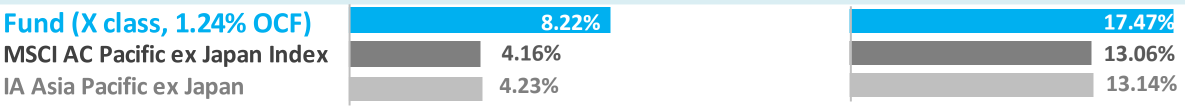
Discrete years % total return

	Mar '13		Mar '14		Mar '15		Mar '16		Mar '17	
	USD	GBP	USD	GBP	USD	GBP	USD	GBP	USD	GBP
Fund (X class, 1.24% OCF)	-	-	-	-	14.5	28.6	-5.6	-2.5	17.6	35.2
MSCI AC Pacific ex Japan Index	11.8	17.6	2.4	-6.7	5.7	18.7	-11.2	-8.3	18.5	36.2
IA Asia Pacific ex Japan	10.2	16.0	2.2	-6.9	6.3	19.4	-11.0	-8.1	17.5	35.1

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)	3.1	2.6	12.0	10.7	17.6	35.2	27.2	69.5	29.6	69.6
MSCI AC Pacific ex Japan Index	2.8	2.4	12.5	11.2	18.5	36.2	11.2	48.3	14.3	49.6
IA Asia Pacific ex Japan	3.8	3.3	12.9	11.6	17.5	35.1	11.2	48.2	14.6	49.9

Annualised % total return from launch



Risk analysis - Annualised, weekly, from launch on 19.12.2013

31/03/2017	Index		Sector		Fund	
	USD	GBP	USD	GBP	USD	GBP
Alpha	0.0	0.0	0.6	1.7	4.9	6.0
Beta	1.0	1.0	0.9	0.9	0.8	0.9
Information ratio	0.0	0.0	0.0	0.0	0.7	0.7
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	0.6	0.1	0.7	0.4	1.0
Tracking error	0.0	0.0	4.0	4.0	5.8	5.8
Volatility	15.2	15.9	13.6	14.1	12.8	14.4

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, 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.

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